CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
ALTERNATIVE INVESTMENT MANAGEMENT (AIM) PROGRAM

April 16, 2001

This Policy is effective immediately upon adoption and supersedes all previous Alternative Investment, Alternative Emerging Investment, and Private Investment Policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for the Alternative Investment Management (AIM) Program ("the Program"), as defined in the AIM Program Strategy ("the Strategy") and AIM Annual Plan. The design of this Policy ensures that investors, managers, external resources, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with this segment of the market. Additional specific information regarding program management may be found in the AIM Program Process Manual available from AIM Staff.

II. STRATEGIC OBJECTIVE

Maximizing risk-adjusted rates of return while enhancing the System's position as a premier alternative investment manager is the strategic objective of the Program.

The Program shall be managed to accomplish the following:

A. Enhance the System's long-term total risk-adjusted return;

B. Enhance the System's reputation as a premier alternative investment manager and "investor of choice" within the private equity community;

C. Hedge against long-term liabilities;

D. Provide diversification to the System's overall investment program; and

E. Consider solely the interests of the System's participants and their beneficiaries in accordance with California State Law and the Prudent

Expert Standard as defined in Section II of the System's Investment Policy.

III. RESPONSIBILITIES AND DELEGATION

A. The **System's Investment Committee** ("the Investment Committee") shall approve and amend the Policy, approve the Strategy and AIM Annual Plan, oversee performance, delegate decision making to the System's Investment Staff ("the Staff") as appropriate and authorize those investment and other decisions which have not been delegated to Staff.

B. Staff duties include, but are not limited to, the following:

1. Make recommendations to the Investment Committee concerning the Program Strategy, Annual Plan, and Policy changes.
2. Manage day-to-day operations; retain, supervise and delegate work to the external resource(s) as appropriate, which may include overseeing due diligence activity.
3. Screen, evaluate and approve investment proposals that meet delegated authority guidelines.
4. Screen, evaluate and recommend investment proposals to the Investment Committee that are beyond the scope of Staff's delegated authority.
5. Monitor and report on Program performance.
6. Market the Program.
7. Manage on an ongoing basis the spring-fed pool of external resources and notify the Investment Committee of changes in its composition.
8. Report any deviations from the Policy to the Investment Committee.

C. **External Resource(s)** ("external resource(s)") shall be retained as part of a spring-fed pool. Their primary purpose shall be to serve as an extension of Staff. External resources may include management consultants, accountants, industry specialists, traditional pension fund consultants, investment bankers, or industry experts. The Staff shall direct and manage the activities of the external resources.

D. **Outside Experts** ("outside experts") may be utilized, as appropriate, to provide specialized expertise in various disciplines, on a one time basis in support of the external resource pool.

IV. LONG-TERM AND SHORT-TERM PERFORMANCE OBJECTIVES

A. Long-Term Performance Objective

The long-term expected performance objective of the Program shall be the 10-year rolling average for the total return of the CalPERS Wilshire 2500 Index plus a 500 basis point risk premium. The performance objective is net of fees and expenses.

Use of the CalPERS Wilshire 2500 Index reflects the opportunity cost of investing in alternative investments versus publicly traded common stocks. The 10-year rolling average smoothes short-term volatility, is intended to cover at least one complete market cycle, and is consistent with the anticipated average term of the partnership investments and the expected average holding period for direct investments.

B. Short-Term Performance Objective

In order to address differences between the long-term performance objective and young or immature partnership investments, the System shall use a short-term performance objective more appropriate to immature partnership investments as a monitoring device. The Program partnership performance shall be compared to Venture Economics Information Services ("Venture Economics") young fund median returns by vintage year. "Young fund and short-term" shall be defined as the first four years of each individual partnership and the partnership composite portfolio. Exceeding the Venture Economics young fund universe median return, or ranking in the top 50% of the sample universe as weighted by AIM Partnership portfolio actual sub-asset holdings over the most recent four years is the short-term performance objective.

The short-term performance objective addresses characteristics of young or immature partnership investments that differ from the long-term rolling ten-year CalPERS Wilshire 2500 Index plus 5% performance objective.

These different characteristics include young partnerships with a shorter time frame, reduced liquidity, and lack of marking-to-market due to a low number of realizations in the early years. Another characteristic unique to young or immature partnership investments includes the "J-curve effect," which results in low or negative returns due to payment of annual management fees during a period when investments are typically carried at cost and returns have not yet been realized. Partnership investments require time to achieve realizations. Venture capitalists require time to build companies and develop value, and turnaround/corporate restructuring managers also require time to implement strategic, financial, and managerial improvements.

V. INVESTMENT APPROACHES AND PARAMETERS

A. General Approach

Under the Program, the Staff shall review and manage investments utilizing a specialized management strategy that shall be disciplined and opportunistic.

Staff shall manage the Program as a whole with specific criteria appropriate to partnership and direct investments. Investment opportunities will be classified as partnership investments when decision-making and management discretion is granted to outside managers. Investment opportunities shall be classified as direct investments if the System retains discretion and manages the investment internally or through its external resource (s).

“Top down” strategic assessments shall identify portfolio weightings and identify the most attractive segments of the market for investing. Based on these assessments, the Staff shall proactively seek out the most attractive investment opportunities, while maintaining appropriate diversification.

B. Program Annual Plan

The Investment Committee and Staff shall review the program annually via the Annual Plan process. The Staff shall develop an Annual Plan each year and present it to the Investment Committee for approval. The Annual Plan shall be based upon broad economic structural analysis, market conditions, and a review of the existing portfolio. The Annual Plan shall detail tactical priorities, costs, resource requirements, marketing plans, strategy enhancements, and other objectives.

C. Program Strategy

The Program Strategy shall be revised periodically as appropriate and updated annually through the Annual Plan.

The Strategy shall contain the following elements:

1. Program goals and objectives;

2. Structure and management of the program;

3. Strategic approach to the asset class;

4. Roles and responsibilities; and

5. Resource requirements.

D. Management of Partnership Investments

The Program shall be continually refined to obtain the most effective mix of investments. The Program shall invest in traditional partnership investments, and, as appropriate, funds employing other structures. Partnerships shall be continually assessed for effectiveness in the following areas:

1. Fit with the Annual Plan;

2. Pace and timing of investment commitments, funding and return of capital;

3. Diversity of sectors (industry, geographical, investment style, and others as appropriate);

4. Performance according to stated objectives specific to the investment; and

5. Performance relative to the short-term monitoring benchmark and to the long-term performance objective, as appropriate.

E. Management of Direct Investments:

The Program shall utilize two types of direct investments: Co-Investments, and Independently Sourced Investments.

1. **Co-Investments** are direct investments by the System together with an existing general partner. The System may invest in the same security or a different security than the general partner. The investment may be with a partnership in which the System has invested or it may be from another partnership sponsored by the same general partner.

2. **Independently Sourced Investments** come to the System through contacts other than the general partners with which the System has invested. The System shall avoid competing directly with its general partners in this segment.

F. Management of Strategic Investment Vehicles

Strategic Investment Vehicles shall include innovative structures that provide a cost effective means to access investment opportunities, exploit the System's strengths, and achieve the maximum risk-adjusted rates of return. Strategic Investment Vehicles may include partnership and/or direct investments.

G. Transaction Processes

1. The Program shall process transactions efficiently. To accomplish this, the Staff shall serve as the "point of contact" regarding all transactions flowing through the System. The Staff shall direct and coordinate the activities of the Program's external resource(s) on a day-to-day basis. The Staff will then be able to monitor and control the process and ensure that due diligence standards are maintained. Additionally, Staff will play a significant role in marketing the program.

2. For Partnerships, the policy goal will be to maintain timely responses to proposals and to process them efficiently and effectively. Partnerships in which the System is already an investor shall be subject to an expedited due diligence process that combines the on-going monitoring assessment with an update of the original due diligence. New partnerships that warrant consideration shall face a full due diligence review. Section VIII.A. contains an outline of the process for evaluating Partnerships.

3. Direct Investments shall also be addressed in a timely fashion. Section VIII.B. contains an outline of the process for evaluating Direct Investments.

4. Strategic Investment Vehicles shall also be processed in a timely manner. Underlying investments shall be evaluated relative to partnership and/or direct investment due diligence criteria as appropriate.

H. Quality Control Processes

The Program shall employ a quality control process, which includes both the Staff and external resource(s) to monitor Program efficiency, track investment performance, and control risk.

1. Process Monitoring - Staff monitors transaction processing to insure timely decision making and an effective process.

2. Monitoring Portfolio Performance - Actual returns are compared to the short and long-term benchmark as appropriate, and to the expected return for the investment.

3. Risk Control - Program standards are maintained through the following processes:

    a. Assessing the level of diversification in the portfolio on a continual basis, including the level of diversification across investment style, geographic distribution, industry concentrations, and across other ranges as appropriate.

    b. Tracking and monitoring due diligence activity and reviewing the external resource's due diligence, monitoring activities and their internal policies and procedures.

    c. Identifying problems early and taking corrective action quickly.

I. Specific Risk Parameters

1. Financial Risk: Alternative investments often employ a greater use of leverage (borrowing), which may lead to a greater volatility in returns. For example, in leveraged buyouts, partnership and direct investments use above average borrowings in their capital structure.

2. Operating and Business Risk: Certain alternative investments entail above average operating and business risk. For example, venture capital investments often entail risks associated with developing new products, establishing new markets, and having untested and incomplete management teams.

3. Liquidity Risk: Alternative investments lack liquidity and typically have time horizons of 5-to-10 years. Secondary markets for such investments are very limited; and, often, there is no current income. The ability to negotiate specific "exit" rights (e.g., registration rights, puts and calls), are generally applicable to direct transactions.

4. Country Risk: Political, economic, and currency risks associated with investing outside of the U.S.

5. Structural Risk: The System negotiates and structures specific fundamental rights and protections, which include mechanisms for taking remedial action. These basic protections include advisory committee participation and specific termination provisions in partnership transactions and anti-dilutions, put and call options, voting rights for material events, and other covenants and governance provisions in the case of direct investments.

6. Valuation Risk: Partnerships shall be evaluated to determine if the general partner employs an appropriate valuation discipline. For direct investments, the Staff shall review valuations to determine if they are reasonable.

7. Investment Evaluation Standards: Depending on the form and character of the investment, the Program sets minimum standards for each investment.

J. Guidelines for Evaluating Proposals

Proposed partnership, direct investment, and strategic investment vehicle opportunities shall be evaluated relative to their fit with the Program's Strategy and Annual Plan.

Exhibits 1 and 2 contain outlines of specific guidelines for partnerships and direct investments, respectively. Strategic investment vehicles shall be evaluated according to the underlying structure of the investment, which may include partnership and/or direct investments.

K. Types of Investments

The System shall consider any appropriate investment opportunity with the potential for returns superior to traditional investment opportunities, and not otherwise prohibited by the System. Investments shall generally fall within the categories defined below.

1. Buyout and Corporate Restructuring Capital: Investments in leveraged buyouts, management buyouts, equity buyouts, employee buyouts, buy-and-build, other acquisition strategies and restructurings, and related uses of capital.

2. Expansion Capital: Investments in established companies for the purpose of growing their businesses.

3. Venture Capital: Investments in relatively small, rapidly growing, private companies in various stages of development.

4. Energy and Natural Resources: Investments in the exploration, extraction, accumulation, generation, movement or sale of energy (e.g., oil, gas, coal, electricity), and other natural resources and related service companies.

5. Distressed Securities: Debt or equity securities investments in troubled companies, under the assumption that the securities will appreciate in value following a restructuring of the company's obligations. This includes, but is not limited to, investments in companies that are insolvent or unable to pay their debts as they come due. This may include companies subject to the Bankruptcy Reform Act, specifically Chapter 7 (Liquidation) and Chapter 11 (Reorganization), and companies under-going restructurings outside of Bankruptcy Court.

6. Turnarounds: Investments in companies experiencing financial or operating difficulties. These companies may or may not be insolvent.

7. International: Investments that are located in foreign countries or have significant portions of their operations outside of the United States. International investments shall also be considered with respect to their specific type (e.g., corporate restructuring, venture capital, and so forth).

8. Special Situations: This includes all other types of investments, e.g., mezzanine strategies, active minority positions, hedge funds, secondary investments, governance strategies, industry specific strategies, and unconventional investments such as debt arrangements, collateralizations, corporate joint ventures, credit enhancements, leasing, off-balance sheet financings, secondary market opportunities, and other types.

VI. BENCHMARKS

The Long-term Benchmark shall be the 10-year rolling average for the total return of the CalPERS Wilshire 2500 Index plus a 500 basis point risk premium. The Long-term Benchmark is net of fees and expenses.

The Short-term Monitoring Benchmark for AIM partnerships shall be to exceed the Venture Economics Young Fund Universe (past four years) median return, or to rank in the top 50% of the sample universe as weighted by AIM partnership portfolio sub-asset holdings over the most recent four years. This analysis shall include performance comparisons by vintage year within each sub-asset class. The System shall use the monitoring benchmark as an early warning device to point out performance for further investigation and possible intervention.

VII. GENERAL

A. GLOSSARY: This Policy contains a Glossary of Terms in Section IX of this document.

B. REPORTING

1. Reports received from Investment Partners

   Staff shall require periodic reports from investment partners to facilitate monitoring and which are appropriate for the specific transaction.

2. Monitoring Investments

   Staff shall monitor individual partnerships, direct investments and the portfolio as a whole. Monitoring includes diversification across alternative investment types and programs to assure an appropriate mix.

3. Performance

   a. Partnership Investments

      The System shall assess the performance of partnerships relative to the following areas:

      (1) Objectives established by the partnership or the principals managing the investment (actual financial performance as compared to original plan)

      (2) Risk undertaken

      (3) Performance of other similar investments

      (4) The short-term monitoring benchmark for partnerships in the first four years of their term

      (5) The long-term performance objective, with appropriate interpretation if applied to the short-term.

   b. Direct Investments

The System shall assess the performance of direct investments relative to the following areas:

(1) Actual financial performance of a company compared to the business plan and strategy

(2) Risk undertaken

(3) The performance of the company against its pro forma operating results, its industry and the total Program portfolio

c. Strategic Investment Vehicles

The System shall assess the performance of Strategic Investment Vehicles according to original plan and partnership and direct investment criteria as appropriate.

4. Investment Committee Reports

Quarterly and annual reports shall be provided to the Investment Committee. These reports include, but shall not be limited to, reviews of investments and their performance.

VIII. SPECIFIC CONSIDERATIONS

A. PARTNERSHIP INVESTMENT GUIDELINES

1. Minimum Requirements/Investment Styles

a. The principals shall demonstrate relevant experience in or directly applicable to the market in which they propose to work.

b. The principals shall demonstrate that they are specifically qualified to pursue the proposed strategy in the market in which they propose to work.

c. The principals shall demonstrate the requisite skills and experience necessary to execute successfully the proposed strategy, including evidence from similar endeavors of their ability to work successfully together.

d. The principals shall dedicate sufficient time and effort to the proposed opportunity and make, within the context of the particular investment, a meaningful personal financial commitment.

e. The proposed strategy and business plan shall be set forth in sufficient detail to permit substantive and meaningful review of the opportunity, verification of the investment concept, and of the risk factors.

f. The proposed strategy and business plan shall provide reasonable assurance that the investment opportunity can produce the required return.

g. The risk/reward trade-off in the particular market that is addressed by a partnership proposal shall be attractive, based on reasonable assumptions.

2. **Evaluation Criteria**

Primary emphasis will be on the quality and experience of the general partners in a partnership investment. Additional factors may include, as appropriate:

a. Fit with the Program Strategy, Annual Plan, and within the overall AIM Portfolio.

b. A unique strategy that is not competitive with existing investments.

c. Integrity of the general partner, its employees, and other investors.

d. Quality of overall partnership governance, management of the partnership, including controls and reporting systems.

e. Specific objectives.

f. Relationship with the relevant parts of the investment community

g. Relationship with limited partners

h. Nature of value added involvement

i. Potentials for co-investments

j. Creativity of the general partners

k. Past financial performance

l. Reasonable ratio of investees to general partners

m. Reasonable ratio of committed capital to general partners

n. Appropriateness of terms and conditions and alignment of interests with limited partners

3. **Due Diligence**

A due diligence review by Staff and external resource(s) selected for reviewing a transaction shall include the following, when applicable:

a. Discussions with principals of the proposed investment.

b. Review and analysis of all pertinent offering documents including: offering memorandums, subscription agreements, private placement memorandums and operative investment agreements.

c. Consideration of potential conflicts of interest, if any, posed by the proposed investment and prior investments and activities of the principals.

d. Review and analysis of the investment concept, including entry and exit strategies and terms including fees, principal participation, and structure.

e. Review and analysis of the fit within the AIM Program, including fit with the Strategy, Annual Plan, other constraints and guidelines, and compliance with applicable investment policies.

f. Review of news articles, principals, prior investments, and concepts.

g. Background and reference check of principals.

h. Review and analysis of track record including performance of prior and current investments.

i. Consideration of relative size of the proposed investment.

j. Investigation of special terms and side letter agreements with past or present investors.

k. Any analysis of the competition between a given proposal and an existing preferential relationship or alternative asset, which may include, but is not limited to, a review of the following: the size of the industry, the segment of the industry, and the deal flow for both the preferential relationship and the proposed investment.

l. Review of any lawsuits, litigation involving the general partner, its principals, employees and prior funds.

4. **Legal Constraints**

a. Unrelated Business Taxable Income (UBTI): Partnerships are structured to minimize UBTI.

b. Registered Investment Advisor (RIA): Investment advisors retained by the Board are so registered or comparable procedure is established.

c. Regulatory (i.e. FCC, SEC, FTC).

5. **Other Parameters**

a. Types of Allowable Investments: Any appropriate investment opportunity which has the potential for returns superior to traditional investment opportunities and which is not otherwise prohibited by The System.

b. Terms and conditions: Fees, preferred returns, profit splits, and other terms and conditions are negotiated as appropriate and when prudent. Partnerships will be prohibited from investing in real estate without approval by The System.

c. Use of Fund's name: Staff and external resource(s) identify any submitted investment opportunity containing as part of its name or title any reference to the System and immediately inform the proposer that inclusion of such a reference or use is inappropriate and unacceptable to the System and require that it be removed.

d. Hostile Transactions: The System maintains the right to examine transactions which might be construed as hostile transactions, with the right to decline participation.

B. DIRECT INVESTMENT GUIDELINES

1. Minimum Requirements

a. Management shall have compiled relevant business and management experience.

b. The entity in which the investment made shall be appropriately capitalized in the relevant circumstances.

2. Evaluation Criteria

Primary emphasis shall be on the following:

a. Integrity of the general partner, its employees, and other investors.

b. The historical and prospective financial condition of the company.

c. The market position of the company, including its relative competitive position within the industry.

d. The growth prospects of the company and its industry in light of existing and anticipated economic conditions.

e. The underlying stability of the company's business.

f. The quality and sustainability of earnings, if appropriate.

g. The quality of the company's assets, such as manufacturing facilities, inventories, receivables, and other assets, including intangibles, essential to the company's operations.

h. Appropriate capital structure.

i. The quality, stability and experience of the management team, the Board of Directors, and other investors, including the quality of their interaction.

j. The quality of financial and operating controls and quality of reporting to management and investors.

k. The quality of the corporate governance.

l. The return potential of the investment, given its terms and conditions, compared to the perceived risks and the relative return/risk profile of comparable investments.

At a minimum, additional factors shall include the following:

a. The specific objectives and goals of the company and its management team.

b. The strategy to be employed to achieve the aforementioned objectives and goals. Management and investors should have a well thought-out plan for creating and realizing value from the company.

c. Controlling shareholder(s) and other institutional investors.

d. The relationship with the management team, the Board of Directors, other investors and any controlling shareholders.

e. Potential for future follow-on investment opportunities.

3. **Due Diligence**

For co-investments, Staff and external resource(s), if utilized, will rely heavily on the work of the general partner sponsoring the transactions, while conducting its own due diligence. Independently Sourced Investments will require a much more in-depth due diligence review because these investments do not come to the System through one of the existing general partners in the portfolio.

A due diligence review by Staff and the external resource if selected for reviewing a transaction shall include the following, when applicable:

a. Review of whether the proposed investment falls within the Strategy, Plan, constraints and guidelines, and if it complies with applicable investment policies.

b. A review and analysis of all pertinent offering documents, including offering memorandums, research reports, annual and quarterly reports, 10K, 8K, 10Q SEC reports and proxy statements.

c. A review and analysis of relevant research reports and news articles regarding the company, its management and its industry.

d. Background checks of the senior management team and any controlling shareholders.

e. A review of the company's historical financial operating results and present financial condition, including examination of auditor reports and possible interview of the auditor.

f. A review and analysis of the company's projected financial operating results with consideration given to the reasonableness of such projections and forecasts.

g. A review and analysis of any contingent liabilities, including potential liabilities related to anticipated legal action, environmental issues, under-funded pensions, taxes and insurance issues.

h. A review and analysis of the company's market position and its standing in its industry.

i. Third party reference checks with key suppliers, customers and, when advisable, competitors.

j. A review of the company’s instruments of indebtedness, corporate instruments, board minutes and any special agreements between the company and other major investors.

k. A review of the company's relationship with its employees, including labor contracts.

l. A review and analysis of all relevant regulations and regulatory reports, examinations and ratings regarding the company and its business sector.

m. On-site visits to the company's principal facilities and corporate headquarters.

n. Interviews with board members, senior management and controlling shareholders.

o. A review of the ownership structure, employee benefit plans and anti-takeover provisions.

p. An analysis of the competition between a given proposal and an existing preferential relationship or alternative asset, which may include, but is not limited to, a review of the following: the size of the industry, the segment of the industry, and the deal flow for the preferential relationship and the proposed investment.

q. In addition to the foregoing and depending on the circumstances surrounding a potential investment, Staff may utilize outside experts to provide further analysis and commentary as to the merits of a particular investment.

4. **Legal Constraints**

a. Unrelated Business Taxable Income (UBTI): Investments are structured to minimize UBTI.

b. Registered Investment Advisor (RIA): Investment advisors retained by the Board are so registered or a comparable procedure is established.

c. Regulatory (i.e. FCC, SEC, FTC)

5. **Other Parameters**

a. Method of Participation: The System generally participates as a preferred or common stockholder or as a senior or subordinated debt investor with a common stock participation.

b. Types of Allowable Investments: Any appropriate investment opportunity which has the potential for returns superior to traditional investment opportunities and which is not otherwise prohibited by The System.

c. Terms and conditions: Fees, preferred returns, profit splits and other terms and conditions are negotiated as appropriate and when possible.

d. Use of Fund's name: Staff and external resource(s) identify any submitted investment opportunity containing as part of its name or title any reference to The System and immediately inform the proposer that inclusion of such a reference or use is inappropriate and unacceptable to the System and require that it be removed.

e. Hostile Transactions: The System maintains the right to examine transactions which might be construed as hostile transactions, with the right to decline participation.

f. Corporate Governance

(1) Voting: The System shall maintain full voting rights with respect to any class of securities in which it might invest. When appropriate, the System may wish to participate as part of a voting trust agreement under which a third party (e.g., a lead investor) retains its proxy to vote the System's interests.

(2) Board of Directors Representation: As circumstances dictate, the System may wish to retain the right to have an independent representative or representatives of the System appointed to a portfolio company's Board of Directors. Furthermore, the Fund should allow the possibility to retain the right to have such representatives participate in select committees of such Board of Directors (e.g., Audit Committee, Executive Committee or Compensation Committee).

g. Board of Directors Visitations Rights: As circumstances dictate, the System should obtain the right to attend, as an observer, a portfolio company's Board of Directors meeting.

h. Board of Directors Composition: As circumstances dictate, the System should obtain agreements as to the composition of a Board of Directors, including guidelines on the number of outside Directors and the composition of key committees.

i. Special Voting Rights: As circumstances dictate, the System should obtain special class voting rights with respect to specific corporate governance matters such as proposals deemed contrary to the System's interests, for example, as in the case of hostile takeovers.

IX. GLOSSARY OF TERMS

The following Glossary of Terms contains definitions also referenced in the System's Master Glossary of Terms.

Advisory Board - A group whose primary functions are to approve valuations of investments made by the partnership and to address conflicts of interest. The Board may also approve distributions, review operating budgets, assure that annual audits are conducted, review the results of these audits, authorize any needed exemptions from partnership covenants, and, when necessary, terminate a general partner.

Aggregation (or Netting) - A portfolio view of a partnership when computing the carried interest or profit split of the partnership between general partners and limited partners.

Alternative Investments - Investments that are privately negotiated, illiquid, and include investment styles (i.e., venture capital, buyout) that are not available in publicly-traded markets. Alternative investments, when fully investigated and properly structured, offer the potential for returns that are significantly above those available from public market alternatives.

Annual Plan - A strategic plan that provides details on tactical priorities for new investments together with a review of the existing portfolio. The first Annual Plan was approved by the Investment Committee on December 16, 1996.

CalPERS Wilshire 2500 Index - A market capitalization-weighted index of the largest 2500 publicly-traded US-domiciled companies, excluding Real Estate Investment Trusts (“REITs”) and tobacco stocks calculated on a custom basis for the System by Wilshire Associates, Inc. The CalPERS Wilshire 2500 Index differs from the standard Wilshire 2500 Index principally due to the exclusion of REITs and tobacco stocks and the date of annual reconstitution of the Index’s constituents.

Carried Interest - The general partner’s share of the profits generated from a partnership. Typically general partners receive 20% of the profits and the limited partners receive 80%.

Clawback Provisions – A partnership provision that allows for a review of the total profit distribution from the partnership at the end of the term. The clawback is a mechanism to recapture overpayments to the general partners if they received more than their stated carried interest. The clawback provision requires return of any excess to the limited partners.

Co-investments - A direct investment by a Limited Partner in a portfolio company in which a fund is invested.

Commitment - A limited partner’s obligation to provide a certain amount of capital to a fund.

Corporate Restructuring - Investments in the equity or debt of a public or private company designed to restructure the outstanding capital profile of that company, including debt and equity buybacks, exchange offers and refinancings. Also known as recapitalizations. Related terms include leveraged buyouts (LBO), management buyouts (MBO) employee buyouts, and buy-and-build strategies.

Direct Investment – A direct investment may be either a co-investment or an independently-sourced investment. Please refer to these respective definitions in this glossary.

Distressed Securities - Investments in debt or equity securities in troubled companies, under the assumption that the securities will appreciate in value following a restructuring of the company's obligations.

Distribution Policy - The term "distribution" relates to how both the general and limited partners receive profits as the investments are liquidated.

Due Diligence - The investigation and evaluation of an investment's characteristics, investment philosophy, and terms and conditions prior to committing capital.

Emerging Markets Funds - Emerging markets are generally considered to be those markets where there is not yet a highly developed public and/or private market for a wide range of companies and equity securities. The most well-known examples of emerging markets include certain countries in Asia, Latin America and Eastern Europe where there have been ideological or structural limitations to profitable business growth. Emerging Market Funds pursue opportunities in emerging markets, including venture capital, special situations, infrastructure investments, corporate restructuring, or a combination of these investment types.

Employee Buyout - Similar to MBO, except that the purchase is by a larger group of employees.

Equity Buyouts - Acquisition of a company for the purpose of restructuring its balance sheet by replacing existing debt with equity.

Expansion Capital - Investment in an established company for the purpose of growing its business.

External Resource(s) – External resources may include management consultants, accountants, industry specialists, traditional pension fund consultants, investment bankers, or industry experts.

General Partner - The managing member of an LLC, or the management company or managing organization of a limited partnership. The General Partner has full responsibility for investing the fund's capital. The General Partner also bears personal liability for any lawsuits that arise from the fund's activities but is often indemnified by the fund.

Hedge Funds - Highly specialized investment strategies in financial securities instruments (including certain derivatives) driven by markets such as the interest rate markets, securities index markets and foreign exchange markets.

Hostile Transactions - Transactions opposed by the Board of Directors of the target company.

Hurdle Rate or Preferred Return - A minimum return that is paid to the Limited Partner before the General Partner receives any share of the profits.

Indemnification - Indemnification provisions seek to protect the members of General Partners from personal liability or loss arising out of their activities in conducting partnership business.

Independently-Sourced Investment – a type of direct investment which is sourced through contacts other than the General Partners with which the System is invested.

Internal Rate of Return - The return received by limited partners that equates the current value of the fund to all the capital contributions into the fund and distributions out of the limited partners. Mathematically, the IRR is the implied discount rate that will make the present value of a stream of cashflows sum to zero.

Key-Man - Key-man provisions address the limited partners' concern for potential turnover of certain named individuals within the general partnership or the retention of a specified percentage of the original general partners.

Leveraged Buyout (LBO) - Purchase of all or part of the stock or assets of a company. The company may be privately or publicly owned, or a subsidiary or division of a privately or publicly owned company. Such investments are typically financed with a significant amount of borrowed capital and a relatively small portion of equity capital, making the company relatively more leveraged following the purchase transaction.

Limited Partner - An investor in a Limited Partnership. Limited Partners provide the capital, but have no direct involvement in the management of the fund. Limited Partners have limited liability but also have limited control over the management of the fund.

Limited Partnership - The most common structure used to organize a private equity fund.

Liquidity – A measurement of how quickly a particular investment can be converted into cash at a low transaction cost.

Look-Back Provisions – Partnership provisions that allow for a review of the total profit distribution from the partnership at the end of the term. The look-back is a mechanism to recapture overpayments to the general partners if they received more than their stated carried interest. The look-back provision requires return of any excess to the limited partners.

Management Buyout (MBO) - Acquisition of a company by its existing management. The financing structure may involve a significant amount of borrowed capital, (thus resembles an LBO), or may have a more balanced debt/equity mix if equity financing is available to management.

Management Fee - The fee paid to an investment manager to cover the expenses of managing a fund. Fees cover expenses such as salaries, travel and office expenses, and costs of developing and monitoring investments. Management fees are typically paid out of a fund's committed capital and are generally returned before the profit is split with the general partners.

Mezzanine Debt - Privately negotiated subordinated debt investments, usually with a parallel investment in equity securities at relatively low cost or at nominal cost.

Most Favored Nation Clause - A clause that states that any side agreements negotiated by other investors will be also extended to the investor who has the most favored nation clause.

No-Fault Divorce - A clause that stipulates the conditions under which limited partners may stop contributing capital to the partnership or even terminate the partnership.

Policy - The Investment Policy for the AIM Program.

Return - A measure of the total performance of an investment over a designated time period. It is comprised of income return and capital appreciation return. The return calculation is typically based upon the internal rate of return (IRR) net of all fees and will be consistent with industry standards.

Risk - The extent to which investment returns fluctuate from period to period. The primary types of risks associated with alternative investments include financial risk, operating and business risk, liquidity risk, structural risk, valuation risk, and country risk when undertaking international investments. (Also see Standard Deviation.)

Special Situations - This is a catch-all category for non-traditional investments that are not otherwise categorized, and including mezzanine strategies, active minority positions, hedge funds, secondary investments, secondary market opportunities, governance strategies, industry specific strategies, and unconventional investments such as debt arrangements, collateralizations, corporate joint ventures, credit enhancements, leasing, off balance sheet financings, and other types.

Secondary Funds - Partnership-style funds formed for the purpose of acquiring limited partnership interests, as a secondary purchase, from an original investor who no longer wants to own the limited partnership interest. These funds are typically purchased at a discount from their estimated value in recognition that the purchaser is acquiring a relatively illiquid investment. Secondary Funds are often considered to be in the Special Situations category.

Staff - The Investment Staff of the System.

Standard Deviation - A statistical measure of the dispersion of returns of an investment. It is a measure of the volatility or risk of an investment.

Strategy - The AIM Program strategy, which was initially approved by the Investment Committee on November 18, 1996 and is revised as appropriate and updated annually through the Annual Plan.

Term - The life of the partnership or direct investment.

Transaction - A partnership or direct investment. The word “transaction” is often used generically to refer to either a potential investment opportunity or to an existing investment.

Turnarounds - Investments in companies experiencing financial or operating problems. These companies may or may not be insolvent.

Unrelated Business Taxable Income (“UBTI”) - Income produced by certain types of investments that is subject to tax (unrelated business income tax or “UBIT”) for tax-exempt investors.

Venture Capital - The financing of relatively small, rapidly growing young companies that do not have access to public equity or debt financing. In recent years, most venture capital opportunities have been in the technology and bio-science areas, but the definition is not limited to those areas. There are further variations depending on how early in the life of the venture the investment is made:

(a) Early-stage venture capital can involve a company right at the start whose only asset is an idea (sometimes sub-divided further as seed financing, start-up financing and first-stage financing);

(b) Later-stage venture capital usually involves an established product, where the company is poised for rapid growth.

Vesting Schedule for the General Partners - The vesting schedule refers to the period of time from fund start-up date that partners of the general partnership are eligible to receive their share of the carried interest.

Vintage Year - The year of first drawdown of capital for investment purposes, which generally coincides with the first year of a partnership's term. Partnerships of the same vintage year are often monitored as a group, in order to assess which partnerships have been most and least effective in capitalizing on economic and market conditions over a common timeframe.

"Winding Down" - Winding down provisions refer to the process of liquidating all remaining investment holdings in the partnership at the end of the term or the effective date of dissolution.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
HYBRID AND HEDGE FUND INVESTMENT VEHICLES – EXTERNALLY MANAGED

February 18, 2003

This Policy is effective immediately upon adoption and supersedes all previous hybrid and hedge fund investment policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for Global Equity, with respect to Hedge Funds and Hybrid Investment Vehicles, including the Joint Global Equity/Alternative Investment Management (AIM) Hedge Fund Program ("the Program"). In addition, this Policy applies to those Hybrid Investment Vehicles enumerated in Section V.B. The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with this segment of the global capital markets.

II. STRATEGIC OBJECTIVE

Broadening the opportunity set of the System's investment portfolio for achieving investment returns not available in traditional public markets investments is the strategic objective of investments in hybrid investment vehicles ("Hybrids") and Hedge Funds

Hybrids and Hedge Funds are offered in a limited partnership or limited liability company (LLC) form, when the majority of the underlying investments are publicly traded. Hybrids and Hedge Funds may include, but are not limited to, corporate governance funds, arbitrage funds, derivative strategies, strategic block investment funds, or crossover funds where the underlying investments consist of both public and private investments.

Hybrids and Hedge Funds shall be selected to accomplish the following:

A. Enhance the System's long-term total return.

B. Hedge against long-term liabilities.

C. Provide diversification to the System's overall investment program.

D. Consider solely the interest of the System's participants and their beneficiaries in accordance with California State Law.

III. RESPONSIBILITIES AND DELEGATIONS

A. The **System's Investment Committee** ("the Investment Committee") is responsible for approving and amending this Policy. The Investment Committee delegates the responsibility for administering Hybrid and Hedge Funds to the System's Investment Staff through the Delegation of Authority (Delegation Nos. 89-13 and 95-50).

B. The **System's Investment Staff's** ("the Staff") duties include, but are not limited to, the following responsibilities:

1. Developing and recommending this Policy to the Investment Committee.

2. Developing and maintaining a procedures manual, subject to periodic reviews and updates, outlining Staff operational procedures used in implementing this Policy.

3. Implementing and adhering to this Policy.

4. Evaluating hybrid and hedge fund investment opportunities, including the possibility of obtaining equity stakes in management firms under this strategy, and recommending actions for new investments to the Investment Committee With respect to the Joint AIM/Global Public Equity Hedge Fund Program only, Staff will bring to the Investment Committee for approval any investment in excess of $200 million.

5. Monitoring selected Investment Partner(s) to determine if the partners' actions and investment results are consistent with the System's manager monitoring policies. Monitoring may be accomplished through a Hybrid Investment Consultant or a Hedge Fund Strategic Partner(s) or Staff.

6. Reporting to the Investment Committee concerns, problems, material changes, and all violations of Guidelines and Policies immediately and in writing, along with explanations and appropriate recommendations for corrective action.

7. For accounting purposes, investments made in private equity securities shall be valued based upon generally accepted methods for such securities including those methods used by the AIM program.

C. The **General Partner(s)** is responsible for all aspects of portfolio management as set forth in the investment partner's contract with the System and shall fulfill the following duties:

1. Communicate with Staff as needed regarding investment strategy and investment results. The investment partner(s) is expected to monitor, analyze, and evaluate performance relative to the agreed-upon benchmark.

2. Cooperate fully with the System's Staff, Custodian, and Hybrid Investment Consultant or Hedge Fund Strategic Partner(s) on requests for information.

3. Comply completely with the System's mandated reporting requirements, including but not limited to, accounting for fees, expenses, capital investments, and dispositions.

D. The **Hybrid Investment Consultant and Hedge Fund Strategic Partner(s)** shall conduct the initial screening of hybrid investments, perform due diligence and evaluate hybrid investment vehicle partnerships and hedge funds as directed by the Staff, prepare independent recommendations regarding partnerships for the Investment Committee and monitor and evaluate performance relative to individual benchmarks and this Policy, in accordance with its contract with the System. In addition, partner(s) may also invest side by side with CalPERS in selected hedge funds.

IV. PERFORMANCE OBJECTIVE

Hybrids and Hedge Funds are highly specialized investments; therefore, the System shall establish performance objectives for each individual Hybrid or Hedge Investment vehicle. These objectives shall be set at levels that are consistent with the strategy employed by the hybrid or hedge fund manager.

Joint AIM/Global Equity Program

1. Target Level Risk

   The target risk level shall be no greater than the expected volatility of CalPERS' Internal Wilshire 2500 Equity Index Fund.

2. The Return Target

   The return target shall be the return of the one-year U.S. Treasury Bill rate plus 7% over a full market cycle (three to five years). On an annual basis and for purposes of performance appraisals, the return target shall be 50% of the return of the Wilshire 2500, plus 50% of the return of the one-year U.S. Treasury Bill rate plus 7%.

3. Liquidity

   In general, expected liquidity for the Program and for individual investments shall be on an annual basis unless investment merits warrant otherwise.

4. Expected Decline in Net Asset Value

   It is expected that the decline in net asset value for the Program will not exceed 10% in any one month.

Return Target for Equity Ownership in Hybrid and Hedge Fund Investment Vehicles

The return target for equity stakes in Hybrid and Hedge Fund Investment Vehicles shall be consistent with the return targets for similar investments in the AIM Program or the Manager Development Program.

V. INVESTMENT APPROACHES AND PARAMETERS

A. Approach

1. Hybrids and Hedge Funds shall be alternatives to other traditional active management vehicles in the Public Markets and AIM Investment Programs. They may include exposure to leverage or short selling of securities or both. Funds for investment in Hybrids and Hedge Funds may come from the active or passive management allocation in each asset

category. Hybrids and Hedge Funds shall not exceed twenty-five percent of the total active management allocation on a market value basis in each asset category.

2. The Program shall use Hybrids and Hedge Funds opportunistically to gain the attractive risk-to-reward characteristics of specialized and unique investment strategies. Hybrids and Hedge Funds are not intended to be a substitute for investment strategies generally available in standard agency agreement format.

3. The Program shall implement Hybrids and Hedge Funds through partnerships, funds, or other formation structures, e.g., limited liability companies (LLCs), where the general partner(s) or fund manager(s) have expertise in the specified mandates and in related areas material to the success of each investment strategy. The justifications for a limited partnership or LLC structure include, but are not limited to, the following:

   a. Financial Firewall: The limited liability of a partnership or LLC arrangement is important since Hybrids and Hedge Funds sometimes use derivatives and leverage. The System, as a limited partner, has the benefit of this limited liability.

   b. Access Unique Approaches with Limited Liquidity: The key to successful Hybrid and Hedge Fund investing is in selecting vehicles where the specialization of the investment is sufficiently unique that the partnership or LLC structure is justified in limiting asset growth in the strategy, ensuring a proper investment time horizon, and protecting the System from the vagaries of other investors who may not be like-minded. The goal is to ensure that the approaches selected for recommendation do not mirror traditional active management. The fees and expenses of investing in Hybrids and Hedge Funds may be higher than traditional active management. The System shall not fund Hybrid and Hedge Funds that simply invest in traditional active management approaches at higher fees.

   c. Access Unique Talent: The specialized and focused nature of Hybrids and Hedge Funds often requires more specialized investment skills than those needed for traditional active management. Some of these investment professionals manage money only in the partnership format or LLC structure.

4. The negotiation of terms in Hybrids and Hedge Funds shall protect the interests of the System, and shall address at a minimum the following issues:

   a. Alignment of Interests: Vehicle terms including fees shall be negotiated to ensure the alignment of the General Partner's interest with the System. The management fee, carried interest, performance objective, return of capital, lock-up period, clawbacks, and other relevant terms shall protect the System in the event of adverse performance results, while ensuring that the limited liability status is maintained. Where appropriate, a return of capital commitments shall be negotiated.

   b. Leverage: It is recognized that Hybrids and Hedge Funds may expose the System's assets to leverage, meaning that a partnership's market exposure may exceed the market value-adjusted capital commitment by the amount of borrowed capital. Negotiation of hybrid investment vehicle terms shall consider The System's stated hybrid level of leverage necessary for achieving the investment's stated objectives without exposing the System to undue risk. The partnership or LLC agreements shall detail the amount of leverage and monitor leverage on a case-by-case basis and in the aggregate, to ensure that expected and realized returns are sufficient and achievable to compensate for the risk incurred. For the AIM/Global Equity Hedge Fund Program, the program limit on leverage shall not exceed 100% of the existing capital without prior Investment Committee approval although individual hedge funds within the program may exceed 100% leverage. For individual funds outside of the AIM/Global Equity Hedge Fund Program, the 100% leverage limitation shall apply.

   c. Reporting Requirements: To appropriately account for fees, individual expenses, invested capital, and any other items affecting the investment, Staff shall prescribe a standard reporting format, which all the General Partners shall follow.

5. The Staff and consultant shall continually review the efficacy of Hybrid and Hedge Fund investment vehicles. The Staff shall present a formal review of the approach to the Investment Committee at least every three years.

B. Investment Selection

1. Hybrids and Hedge Funds may be selected if they enhance the investment program within each asset class achieving the overall asset class investment goal. Hybrids and Hedge Funds may include investments in domestic and international equity and fixed income asset classes in strategies that may include, but are not limited to, the following areas but must be subject to asset class restrictions:

   a. Relative Value Funds

   b. Market Neutral Funds

   c. Arbitrage Funds

   d. Corporate Governance Funds

   e. Derivative-Based Strategy Funds

   f. Concentrated or Strategic Block Funds

   g. Crossover Funds (where public securities and private investments are included in the partnership)

   h. Long/Short Equity Funds

2. The following hedge fund investment styles will be considered for the Joint Global Equity/AIM Program:

   a. Convertible Arbitrage

   b. Statistical Arbitrage

   c. Merger/Transaction Arbitrage

   d. Long/Short Equity Funds

   e. Cross Over Funds

f. Market Neutral

3. The Staff shall develop and maintain selection guidelines for Hybrids and Hedge Funds to include the following:

   a. Minimum requirements with respect to the following:

      (1) General Partner Investment Experience

      (2) Basic Investment Vehicle Terms

      (3) Investment Goals and Objectives

      (4) Degree of Leverage

   b. Performance Criteria

   c. Due Diligence Process

   d. Legal Constraints or Requirements

   e. Hedge fund funding

   f. Reporting Requirements

   g. Quality control processes including, but not limited to, investment monitoring and risk control

   h. Other relevant parameters that may apply

4. Staff shall review opportunities to obtain an equity stake in Hybrid and Hedge Fund managers and make recommendations to the Investment Committee as appropriate. CalPERS shall not take equity stakes in managers without Investment Committee approval, regardless of the value of assets CalPERS places with the Fund. A separate portfolio will be established to provide for performance measurement of CalPERS' equity stakes in Hybrid and Hedge Fund managers.

5. Except as is consistent with Staff's responsibilities and delegations under Section III.B.4, the Staff, the Hybrid Investment Consultant and the Hedge Fund Strategic Partner(s) shall review opportunities in Hybrids and Hedge

Funds and make recommendations to the Investment Committee as appropriate.

C. Investment Parameters

Investment partner(s) in Hybrids and Hedge Funds shall operate under a limited partnership agreement, or other similar legal structure, which includes specific, written investment guidelines. The guidelines shall outline the investment partner(s)' investment philosophy and approaches, representative portfolios characteristics, permissible and restricted securities and procedures, and a performance objective commensurate with the investment risk to be incurred.

Implementation of this Program shall comply at all times with the applicable System investment policies.

VI. BENCHMARKS

Due to the wide range of markets in which these investments shall be made, appropriate benchmarks shall be established for each specific hybrid and hedge fund investment vehicle. They shall reflect the investment opportunity set or risk profile of each investment. These benchmarks shall be established prior to investment and shall be documented with each hybrid and hedge fund manager.

VII. GENERAL

A. This Policy contains a glossary of terms in Section VIII of this document

B. Investors, managers, consultants, or other participants selected by the System shall make all calculations and computations on a fair-market-value basis as recorded by the System's Custodian. In the case of private investments, calculations and computations shall be made consistent with the partnership agreement, unless otherwise approved by the Investment Committee.

VIII. GLOSSARY OF TERMS

The following Glossary of Terms contains definitions also referenced in the System's Master Glossary of Terms.

Arbitrage Funds – These are hedge funds that buy and sell similar securities to take advantage of price differentials that may lead to a profit. For example these strategies may be associated with a corporate announcement, such as merger arbitrage, to earn a rate of return that is independent of the general stock market. As another example, these funds buy and sell the securities of the same company, such as convertible arbitrage, to earn a rate of return that is independent of the general stock market.

Clawbacks – Provisions allowing a review of the total profit distribution from a partnership at the end of the investment term. Clawback provisions facilitate the recapture of overpayments to the general partners if they received more than their stated carried interest.

Concentrated or Strategic Block Funds – These are funds that focus their investments in relatively few companies. Their intent is usually to gain Board of Directors representation or to sell their investment stake back to the company at a premium.

Convertible Arbitrage - Generally involves the purchase of a convertible bond while simultaneously hedging the equity component of the bond to lock in a higher-yielding instrument than straight debt.

Corporate Governance Funds – These are funds that effect changes in both the corporate governance and operating policies of public companies with the expectation of improved stock price performance.

Crossover Funds – These are hedge funds that contain both a public markets component and a private markets component. Generally, the public market component is much larger and is in the form of a long/short strategy

Custodian – A bank or other financial institution providing the custody of stock certificates and other assets of an institutional investor.

Derivative – An instrument whose value, usefulness, and marketability is dependent upon or derives from an underlying asset. Classes of derivatives include futures contracts, options, currency forward contracts, swaps, and options on futures.

Derivative Base Strategies – These are funds that invest in markets typically dominated by derivative instruments. For example, commodity funds typically invest in futures contracts and currency funds typically invest in forward contracts and swap agreements.

Derivatives Policy –the System's Statement of Derivatives Policy.

External Manager – A money management firm retained under contract by the System.

Financial Firewall – The legal protection from financial liability extending beyond the value of the investment in the Limited Liability Company or Limited Partnership.

General Partner – The manager of a limited partnership. The general partner has full responsibility for investing the capital. The general partner also bears personal liability for any lawsuits that arise from the investment's activities, but is often indemnified by the fund.

Hybrid Investment Consultant and Hedge Fund Strategic Partner(s) – One or more partner(s) will be chosen to help develop the Joint AIM/Global Equity Hedge Fund Program. The partner(s) may be responsible for screening, due diligence, advice on selection, monitoring, and risk management

Hybrid Investments - Investments that are offered in a limited partnership or limited liability corporate (LLC) form, where the underlying investments in the majority are publicly traded. Hybrid investments may include, but are not limited to, corporate governance funds, hedge funds, arbitrage funds, derivative strategies, strategic block investment funds, or crossover funds where the underlying investments consist of both public and private investments.

Hybrid Investment Vehicle – An investment typically structured as a limited partnership that is expected to achieve investment returns significantly above those available in traditional public market investments. Investments may be in domestic, international, public and private market equity, or fixed income securities, financial derivatives, short positions in publicly traded domestic and international equity and fixed income securities, and may employ leverage.

Investment Partner/Limited Partner – An investor in a limited partnership. Limited partners provide the capital, but have no direct involvement in the management of the fund. Limited partners have limited liability but also have limited control over the management of the fund.

Leverage – A condition where a portfolio's market obligation may exceed the market-value-adjusted capital commitment by the amount of borrowed capital (debt).

Limited Liability Company (LLC) – An alternative structure to a limited partnership. It is often described as a hybrid between a corporation and a partnership because it offers limited liability like a corporation and single taxation on income like a partnership.

Limited Partnership – The most common format used in structuring private equity investments. Limited partners provide the capital, but have no direct involvement in the management of the fund. Limited Partners have limited liability but also have limited control over the management of the fund.

Liquid/Liquidity – The ability to convert quickly a particular investment into cash at a low transaction cost.

Long/Short Equity Funds – These are hedge funds that establish both long equity positions and short equity positions to extract the maximum value from their investment information set.

Market Neutral Funds – These are hedge funds that attempt to remove or neutralize systematic market and industry risk while focusing on stock selection risk.

Merger/Transaction Arbitrage - These are hedge funds that make investments in companies that have announced a significant corporate transaction such as a merger, acquisition, spinoff, etc. The strategy is to capture a market premium for bearing the risk that the transaction will not be completed.

Partnership Agreement – Legal document that sets forth the terms and conditions of a private equity or hybrid investment vehicle. The partnership agreement also establishes the roles of general and limited partners.

Policy – The System's Investment Policy for Hybrid and Hedge Fund Investment Vehicles – Externally Managed.

Relative Value Funds – These are funds that compare the prices of two similar securities and buy the security that appears relatively cheap and sells the security that appears relatively expensive.

Statistical Arbitrage - These are hedge funds that use quantitative models to remove all common sources of risk from an equity portfolio (size, book to market value, market, dividend yield, etc.) so that only stock selection risk remains. Different from market neutral managers in that quantitative factor models are used to identify and minimize risk.